

**DEPARTMENT OF STATE REVENUE**

**LETTER OF FINDINGS NUMBER: 00-0008**

**Gross Income Tax**

**For Tax Years 1995 through 1997**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

**ISSUES**

**I. Gross Income Tax—Tooling Sales**

**Authority:** IC 6-2.1-3-3

Taxpayer protests imposition of Gross Income Tax on income from sales of tooling during audit period.

**II. Gross Income Tax—High Rate Tax**

**Authority:** IC 6-8.1-5-1; IC 6-8.1-5-4; 45 IAC 1-1-21

Taxpayer protests imposition of high rate income tax on tooling.

**III. Tax Administration—Negligence Penalty**

**Authority:** IC 6-8.1-5-4; 45 IAC 15-11-2

Taxpayer protests imposition of a ten percent (10%) negligence penalty.

**STATEMENT OF FACTS**

Taxpayer manufactures parts for the automotive industry. The auditor assessed gross income tax on income from the sales of tooling taxpayer bought from out-of-state suppliers and sold to its in-state customer. Taxpayer protests the assessments. Further facts will be supplied as required.

**I. Gross Income Tax—Tooling Sales**

### **DISCUSSION**

As a result of a gross income tax audit, the Department of Revenue issued assessments on income generated by sales of tooling by the taxpayer to its Indiana customer. Taxpayer protests that the sales of tooling took place outside of Indiana. Taxpayer was unable to produce documentation to support that position during the audit. The Department proceeded to issue the assessments based on the best information available.

Taxpayer contends the Department proposed assessments because taxpayer and its customer are both located in Indiana, and the sale of the tooling represents a sale between two Indiana corporations subject to Indiana Gross Income Tax. This is not the Department's position. The Department's position is that the tooling was in Indiana when taxpayer sold it to its customer, and therefore the sale of the tooling subjects taxpayer to the Gross Income Tax. During the audit, the Auditor asked taxpayer to provide documentation verifying the location of the tooling, but taxpayer did not provide any. As part of this protest, taxpayer did provide documentation verifying the location of the tooling after the audit period.

In its protest, taxpayer raises the Commerce Clause and Due Process Clause of the United States Constitution. IC 6-2.1-3-3 states:

Gross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign country is exempt from gross income tax to the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution.

Taxpayer's arguments rely on where the tooling was located. At hearing taxpayer provided documentation showing that approximately eighty-five percent (85%) of the tooling was located outside of Indiana after the audit period. Taxpayer has not established that the tooling was outside of Indiana during the audit period.

### **FINDING**

Taxpayer's protest is denied.

## **II. Gross Income Tax—High Rate Income Tax**

### **DISCUSSION**

As a result of the audit for the tax years at issue, the Department issued its assessments of the tooling sales at the high rate of tax. Taxpayer protests that the tooling which is subject to Indiana Gross Income Tax is subject to the low rate of tax. Taxpayer states that it does not capitalize the cost of the tooling. Taxpayer reported the sale of the tooling as gross receipts on its 1997 Federal return. Taxpayer asserts that despite this, the tooling does not satisfy the definition of a capital asset as it is not a depreciable asset to taxpayer.

The regulation defining capital assets for the tax years in question was 45 IAC 1-1-21, which states in part:

The term “capital assets” as used in this Act *[IC 6-2.1]* includes all assets except stock-in-trade of a retail merchant held primarily for sale to a customer in the regular course of a trade or business (see Regulations 6-2-1-1(j)(010) *[45 IAC 1-1-13]* and 6-2-1-3(c)(010) *[45 IAC 1-1-88]*), inventory held as raw materials, goods-in-process, or finished goods for use in the production of a product eventually to be sold as provided in IC 6-2-1-3(a) *[Repealed by P.L. 77-1981]*, *SECTION 22.* of the Gross Income Tax Act. Receipts from the sale of capital assets are taxed at the higher rate without any deductions for cost, loss or expenses with the exception of a mortgage held on real estate.

The Department based its assessments on the best information available during the audit. As part of this protest, taxpayer provided documentation supporting its position. In this case, given the taxpayer’s acquisition methods and use of the tooling, the Department does not consider the sale of tooling as the sale of a capital asset. The Department agrees that the sale of the tooling in this case is subject to the lower rate.

### **FINDING**

Taxpayer’s protest is sustained.

### **III. Tax Administration—Negligence Penalty**

### **DISCUSSION**

Taxpayer protests the imposition of a ten percent (10%) negligence penalty. Taxpayer states that the assessments in question are insignificant when compared to its total business activity. Taxpayer argues that the amount of taxes assessed is relatively insignificant compared to the amount of transactions involved and the amount of tax correctly paid. Taxpayer also states that taxing authorities have never demanded absolute perfection in accounting procedures to avoid negligence penalties, and that Federal courts have noted that a few inaccuracies in bookkeeping do not amount to negligence. The relevant regulation is 45 IAC 15-11-2(b), which states:

“Negligence” on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable person. Negligence would result from a taxpayer’s carelessness, thoughtlessness, disregard or inattention to duties placed on it by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules, and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

Taxpayer believes that its facts and circumstances warrant dismissal of the negligence penalty. The Department refers to IC 6-8.1-5-4(a), which states:

Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

Also, IC 6-8.1-5-4(c) states:

A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times.

In this case, taxpayer failed to keep records for the auditor to review in order to determine the amount, if any, of the taxpayer's liability. While taxpayer was eventually able to produce documentation supporting its position, this documentation was not available until it was provided in this protest. Taxpayer failed to comply with the record keeping requirement of IC 6-8.1-5-4, and was therefore negligent as described in 45 IAC 15-11-2(b). If this documentation had been available during the audit, much of the time and effort for taxpayer and the Department could have been saved. Therefore, all assessments remaining after audit verification on Issues 1 and 2 will be subject to the ten percent (10%) negligence penalty.

### **FINDING**

Taxpayer's protest is denied.

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